93-136

No._____

In The

Supreme Court of the United States

October Term, 1993

A. LAWRENCE WASHBURN, JR.,
SUSANNE WASHBURN,
Petitioners-Appellants,

-against-

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I

Whether requiring a cash basis taxpayer to claim an unpaid fee as income before allowing it to be deducted as a business bad debt is unfair, unreasonable, and inconsistent with the Code in light of its 1942 amendment.

II

Whether the expenses incurred by Susanne Washburn by traveling from her home in Vermont to her place of work in New York City are deductible travel expenses because the Washburns lived in Vermont due to financial hardship rather than personal choice.

PARTIES

The caption lists all of the parties in the United States Court of Appeals for the Second Circuit. No party is a corporation under Rule 28.1.

TABLE OF CONTENTS

Page

Table of Cases iv

Table of Statutes iv

Opinions Below 1

Jurisdiction 2

Statutes Involved 2

Regulation Involved 5

Statement of the Case 5

Reasons for Granting the Writ 9

I TREASURY REGULATION 1.166-1(e) CONTRADICTS THE CLEAR INTENT OF CONGRESS AND IS BASED ON CASE LAW PRIOR TO THE 1942 AMENDMENT. 9

II A TAXPAYER FORCED BY THE FINANCIAL HARDSHIP OF HER HUSBAND TO TRAVEL OVERNIGHT AWAY FROM HOME IN ORDER TO KEEP HER JOB MAY DEDUCT HER TRAVEL EXPENSES UNDER SECTION 162 (a) (2) 11

Conclusion 15

Appendix A A1

Appendix B A10

Appendix C A15

TABLE OF CASES

Pages

Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984) 11

Comm. v. Flowers, 326 U.S. 465 (1946) 12, 13, 14

Comm. v. Heininger, 320 U.S. 467 (1943) . . . . . 12, note 4

Gertz v. Comm., 64 T.C. 498 (1975) 10

Harris v. McRae, 488 U.S. 297 (1980) . . . . . 5, 13, note 9

Helvering v. Winmill, 305 U.S. 79, 83 (1938) 11

McCabe v. Comm., 688 F2d 102 (CA2, 1982) . . . . 12, note 5

Peurifoy v. Comm., 358 U.S. 59 (1958) . . . . . 12, note 7

Rosenspan v. United States, 438 F2d 905 (CA2, 1971) 13

Six v. United States, 450 F2d 66 (CA2, 1971) 12

Webster v. Luther, 163 U.S. 331, 342 (1896) 11

TABLE OF STATUTES

I.R.C. of 1954, Sec. 162 (a)(2) . . . . . *passim*

I.R.C. of 1954, Sec. 166 . . . . . *passim*

I.R.C. of 1954, Regulation 1.166-1(e) . . . . . *passim*

In The

In the Supreme Court of the United States

October Term, 1992

A. LAWRENCE WASHBURN, JR. and
SUSANNE WASHBURN,
Petitioners-Appellants,

v. Docket No. 8580-88

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioners, A. Lawrence Washburn, Jr., and Susanne Washburn, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in the above-entitled proceeding on March 26, 1993.

OPINIONS BELOW

The opinion of the Second Circuit was in the form of a Summary Order, consisting of four (4) pages and will not be reported. Said opinion is reproduced in the Appendix at A-10 to A-14.

The opinion of the United States Tax Court (Swift, J.) is reported at 61 T.C.M. (CCH) 2529 (1991).

JURISDICTION

Petitioners timely filed a petition in the Tax Court, seeking a redetermination of the deficiencies in income tax and additions to tax for the taxable year 1984 asserted by the Commissioner of Internal Revenue. The Tax Court had jurisdiction pursuant to Sections 6213 and 7422 of the Internal Revenue Code of 1986 (26 U.S.C.).

The Tax Court upheld, in substantial part, the Commissioner's deficiency determination and addition to tax against petitioners. Pursuant to an agreed computation between petitioners and the Commissioner, the Tax Court entered its decision on October 15, 1991. This decision constitutes a final, appealable order disposing of all the issues with respect to the parties.

Petitioners filed a notice of appeal to the United States Court of Appeals for the Second Circuit from the decision of the Tax Court on January 9, 1992. Jurisdiction of that appeal was conferred by Section 7482(a) of the Internal Revenue Code of 1986 (26 U.S.C.). The appeal was timely under Section 7483, which allows 90 days for taking an appeal after the decision of the Tax Court is entered.

The judgment of the Court of Appeals was entered on March 26, 1993 and is reproduced in the appendix. On June 15, 1993, the Hon. Clarence Thomas extended the time in which to file this petition to and including July 23, 1993 and said Order is reproduced in the appendix. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 162. TRADE OR BUSINESS EXPENSES. [as amended by Sec. 139(b)(1) of Public Law 97-51, Oct. 1, 1981]

(a) **In General**—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) [as amended by Sec 4(b), Revenue Act of 1962, Pub. L. No 87-834, 76 Stat. 960] traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

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Sec. 166. BAD DEBTS.

(a) **General Rule**—

(1) *Wholly worthless debts*—There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

(2) When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

(b) *Amount of Deduction*—For purposes of subsection (a), the basis for determining the amount of the deduction for any bad debt shall be the adjusted basis provided in the section 1011 for determining the loss from the sale or other disposition or property.

(c) *Reserve for Bad Debts*—In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary) a deduction for a reasonable addition to a reserve for bad debts.

(d) *Nonbusiness Debts*—

(1) *General Rule*—In the case of a taxpayer other than a corporation—

(A) Subsections (a) and (c) shall not apply to any nonbusiness debt; and

(B) where any nonbusiness debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the taxable year, or a capital asset held for not more than 6 months.

(2) *Nonbusiness debt defined*—For purposes of paragraph (1), the term "nonbusiness debt" means a debt other than—

(A) a debt created or acquired (as the case may be) in connection with a trade or business of the taxpayer; or

(B) a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business

★ ★ ★ ★

Sec. 262. PERSONAL, LIVING, AND FAMILY EXPENSES.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

REGULATION INVOLVED

Treasury Regulations on Income Tax (1954 Code) § 1.166-1(e) (26 C.F.R.) provides as follows:

> Worthless debts arising from unpaid wages, salaries, fees, rents, and similar items of taxable income shall not be allowed as a deduction under section 166 unless the income such items represent had been included in the return of income for the year for which the deduction as a bad debt is claimed or for a prior taxable year.

STATEMENT OF THE CASE

Petitioner, A. Lawrence Washburn, Jr. is an attorney licensed to practice law in the State of New York. After graduating from law school in 1966, Mr. Washburn worked for several law firms in New York City, where he resided with his wife, petitioner, Susanne Washburn, and their three children. Petitioners moved their family to a house in Vermont in 1983 and they lived there during 1983 and 1984. Mr. Washburn testified that the move from New York City to Vermont was the result of financial hardship resulting from

nonpayment of legal fees for his work in *Harris v. McRae*, 488 U.S. 297, from 1976 - 1980.

During 1984, Mr. Washburn rendered legal services to Gene Crescenzi for which he billed Mr. Crescenzi $10,525. Mr. Washburn maintained records with respect to his practice of law on the cash method of accounting, and Mr. Washburn did not include the $10,525 billed to Mr. Crescenzi in his income for 1984 (nor any other year). During 1984 and up to the time of trial, Mr. Crescenzi failed to pay Mr. Washburn the $10,525.

During 1984, petitioner Susanne Washburn worked part-time for Time Magazine at its office in New York City where she had been employed for 25 years. Generally, on Wednesday mornings, Mrs. Washburn drove with her husband from their residence in Vermont the 215 miles into New York City. On Wednesdays, Thursdays, and Fridays of each week, Mrs. Washburn worked at the Time Magazine office. On Wednesday and Thursday evenings, petitioners stayed overnight in New York City with a friend. On Friday afternoons, Mr. Washburn alone drove the family automobile the 215 miles back to taxpayers' residence in Vermont. Mrs. Washburn worked at the Time Magazine office in New York City until late on Friday evenings and then returned alone by bus to taxpayers' residence in Vermont.

On their joint income tax return for 1984, petitioners claimed, as a business expense deduction under Section 162 of the Internal Revenue Code, the expenses incurred by Mrs. Washburn in traveling between her residence in Vermont and her place of employment in New York City. Petitioners also claimed on that same return a business bad debt deduction for the legal fees that were owed by Mr. Crescenzi, but never paid, to Mr. Washburn. Petitioners did not include the unpaid fees as income on their return.

Upon audit, the Commissioner determined, *inter alia*, that Mrs. Washburn's expenses of traveling between Vermont and New York

City constituted non-deductible personal expenditures under Section 262 of the Code. The Commissioner further determined that taxpayers could not claim a bad debt deduction with respect to the unpaid legal fees owed to Mr. Washburn by Mr. Crescenzi because they had not reported those fees as income on their return. Finally, the Commissioner determined that taxpayers were liable for additions to tax for negligence under Section 6653 of the Code and for substantially understating their tax liability under Section 6661 of the Code.

Petitioners argued in Tax Court and in the Court of Appeals that requiring a cash basis taxpayer to claim an unpaid fee as income before allowing it to be deducted as a bad debt is unfair, unreasonable and inconsistent with the Code in light of its 1942 amendment, which simplified the business bad debt deduction by removing a technical restriction. Further, petitioners argued in both courts that the expenses incurred by Mrs. Washburn by traveling from her home in Vermont to her place of work in New York City are deductible travel expenses because the Washburns lived in Vermont due to financial hardship rather than personal choice.

The Tax Court upheld the Commissioner.[1] The court pointed out that Mrs. Washburn's travel between Vermont and New York City was the result of petitioners' decision, for personal reasons, to maintain their residence in Vermont and was not the result of the requirements of Mrs. Washburn's employment with Time Magazine in New York City. It therefore followed, the court concluded, that Mrs. Washburn's travel expenses constituted nondeductible personal expenses and not deductible expenses of her trade or business.

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[1] The parties reached a settlement in the Tax Court as to other adjustments to taxpayers' income made by the Commissioner in his notice of deficiency and as to Mr. Washburn's travel expenses.

The Tax Court further held that is was established, both by the Treasury Regulations promulgated under Section 166 of the Code and by uniform case law, that a taxpayer may not claim a bad debt deduction for unpaid wages, fees, etc. unless he has reported the unpaid amounts due him as income on his return for the year in which he claims the deduction or in some earlier year. Because petitioners had never reported as income the fees due Mr. Washburn from Mr. Crescenzi, they were precluded from claiming a bad debt deduction with respect to such fees.

Finally, the Tax Court upheld the additions to tax imposed by the Commissioner.

On appeal in the Second Circuit, the Court of Appeals held that a regulation imposing a different technical requirement than that removed by the 1942 amendment was not inconsistent with the Code's purpose in simplifying the business bad debt deduction. The Court of Appeals further held that acceptance of an argument of business necessity for Mrs. Washburn's travel expenses would be inconsistent with this Court's decision in *Commissioner of Internal Revenue v. Flowers*, 326 U.S. 465, 470 (1946):

> "If this argument were to prevail it would result in all taxpayers being able to claim their traveling expenses as deductions in circumstances where they could not afford to maintain a residence near their place of work."

Accordingly, the Court of Appeals affirmed the judgment of the Tax Court.

REASONS FOR GRANTING THE WRIT

I

Treasury Regulation 1.166-1(e) contradicts the clear intent of Congress and is based on case law prior to the 1942 amendment.

Treasury Regulation 1.166-1(e) requires that a cash basis taxpayer "include" a business bad debt in income before he can deduct it.

This requirement engages in a nationwide legal fiction because a cash basis taxpayer *cannot* include in income that which he has not received.

Moreover, to "include" the amount *not* received in income on the cash basis method of accounting would offset and therefore cancel the benefit of the business bad debt deduction.

This means that *all* cash basis taxpayers are denied, *a priori*, *all* business bad debt deductions described in Regulation 1-166-1(e) *solely* because they use the cash basis method of accounting and for *no* other reason.

While Regulation 1.166-1(e) does not refer on its face to any method of accounting, its intended effect is prominently displayed by the Commissioner, as conceded in the courts below, by the following standard language contained in the *Instructions for Form 1040* in 1984 and currently (and in substantially similar language in Publication 548, "Deduction for Bad Debts"):

> "*Caution*: Cash method taxpayers are not entitled to a bad debt deduction unless the amount was previously included in income."

Regulation 1.166-1(e) represents a policy which contradicts the plain language and intent of Section 166 of the Internal Revenue Code.

There can be no question that this policy, which has received no legislative notice[2] since 1942, has effected a massive tax inequity upon those taxpayers least able to afford it.

In 1942, Congress simplified the bad debt deduction for business bad debts which become wholly worthless within the taxable year. Section 166, which carries forward that amendment allows as a deduction "any debt" which becomes wholly worthless within a taxable year. Regulation 1.166-1(e) contradicts that language, and its plain intent, by stating that "some" debts which become wholly worthless within a taxable year are *not* deductible.

The types of debts selected by Regulation 1.166-1(e) are traceable to a trilogy of cases decided prior to the 1942 amendment. See *Gertz v. Comm.*, 64 T.C. 598 (1975) (relying upon pre 1942 cases in upholding Regulation 1.166.1(e)). All case law on the subject has uncritically relied upon *Gertz v. Comm., supra*, until the reasoning of that case was challenged in the present litigation.

In the case at bar, the Commissioner stipulated in Tax Court to all elements necessary for a business bad debt deduction *except* the cash basis method of accounting, thus isolating the validity of Regulation 1.166-1(e) as a question presented for appellate review.

While the Tax Court in the case at bar again relied upon *Gertz v. Comm., supra*, the Court of Appeals did not do so.

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[2] In Documents 16 and 17 in the tax court, petitioners sought legislative history and documents supporting regulation 1.166-1(e). The Government referred only to case law. This position was repeated in the Court of Appeals.

The Court of Appeals acknowledged that the 1942 amendment had removed technical restrictions but held that the restriction imposed by Regulation 1.166-1(e) was not the same as the restriction removed by Congress in 1942.

The holding of the Court of Appeals in the case at bar fails to deal with the fact that Regulation 1.166-1(e) nevertheless contradicts the plain language and intent of Section 166.

The Court of Appeals holding is therefore contrary to the holdings of this Court that administrative regulations are illegal if they are inconsistent with the clear intent of Congress. *Webster v. Luther*, 163 U.S. 331, 342 (1896); *Chevron U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837, 843, note 9 (1984).

Since Regulation 1.166-1(e) has apparently received no legislative notice since 1942, it should not be deemed to have Congressional approval[3] under the doctrine of *Helvering v. Winmill*, 305 U.S. 79, 83 (1984).

II

A taxpayer forced by the financial hardship of her husband to travel overnight away from home in order to keep her job may deduct her travel expenses under Section 162 (a) (2)

The opinion of the Tax Court elected between two lines of Second Circuit precedents[4] based upon a fact asserted by the Commissioner

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[3] This issue was not briefed by the parties in the Tax Court or in the Court of Appeals. However, the issue was raised on oral argument in the Court of Appeals by Hon. Morris E. Lasker, although it was not addressed in the opinion of the Court of Appeals.

[4] Since the Tax Court placed principal reliance on Second Circuit precedents and the Commission offered no testimony and stipulated to the facts, a question of

but for which there was no evidence in the record, *viz.* that petitioners moved to Vermont by "personal choice."

The facts stipulated by the parties and adopted by the Tax Court show that petitioners moved to Vermont due to "financial difficulties." The only witness, the husband, testified that appellants were forced by economic hardship of the husband rather than personal preference to live in Vermont temporarily.

Since there was no evidence in the record to support an inference that petitioners would choose to drive 430 miles each week for substantially every week in 1984, absent economic hardship, the Tax Court's reliance on the Second Circuit's "personal choice of where to live cases"[5] were obviously misplaced.

Given the fact of the husband's financial hardship and the temporary loss of petitioners' home in New York City, the question then becomes whether the Tax Court's effort to distinguish the precedent in *Six v. United States*, 450 F2d 66, 69 (CA2, 1971), relied upon in the Tax Court by petitioners, was proper.

At the threshold, it must be acknowledged that the facts in *Six, supra*, did not involve financial hardship. Also, the Court remanded that case for further proceedings under the third prong of the Section 162 test announced in *Flowers*[6] and the "temporary" exception for expenses away from home announced in *Flowers* and *Peurifoy*.[7] *Six, supra*, 450 F2D, at 69-70. Thus, no precedent with respect to the "temporary" nature of the employment or business necessity was

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(cont'd) law was "unmistakably involved." *Comm. v. Heininger*, 320 U.S. 467 (1943).

5 See *McCabe v. Comm.*, 688 F2d 102, 106 (CA2, 1982); *Corragan v. Comm.*, 197 F2d 246, 249 (CA2, 1952), relied upon by the Tax Court as "personal choice of where to live" cases. Each involved a trip of one to two hours as opposed to the 5-hour drive from appellant's home in southern Vermont to New York City.

6 *Comm. v. Flowers*, 326 U.S. 465 (1946).

7 *Peurifoy v. Comm.*, 358 U.S. 59 (1958).

applicable. Nevertheless, petitioners respectfully submit that where home and business are temporarily separated by economic hardship, the pattern adopted makes business sense under *Flowers* and is reasonable.

The Tax Court implicitly recognized that the particular items of expense, automobile and bus expense, satisfied the first prong in *Flowers*, as set forth by the Court in *Rosenspan*.[8] Then the Tax Court expressly acknowledged that petitioners' "home" as described in Section 162 (a) (2) was their home in Vermont, rejecting the Commissioner's "tax home" analysis as being unavailable in the Second Circuit. Finally, the Tax Court examined the third prong of the *Flowers* test, which the Second Circuit has held, will often lead to the same result as "tax home" analysis, *viz.*, "a direct connection between the expenditure and the carrying on of a trade or business." *Flowers, supra*, at 470, *Six, supra*, at 69.

In the case at bar, a taxpayer with long standing employment at Time Magazine incurred travel expenses during a temporary period of financial hardship for her husband, who had not been paid for most of his work in a major case.[9] Such travel was necessary for her trade or business and was designed to last only until the family income could again support the expenses of maintaining a home in New York City, as shown by the only testimony in the record.

The Tax Court and the Court of Appeals erred in insufficiently analyzing business necessity under the third prong of *Flowers* and the perceived "temporary" nature of the economic hardship, as required by *Flowers* and *Peurifoy*.

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8 *Rosenspan v. United States*, 438 F2d 905 (CA2, 1971).

9 The record shows that economic hardship for the husband was nonpayment of fees for his work in *Harris v. McRae*, 488 U.S. 297, from 1976-1980.

The Commissioner did not argue in the Tax Court that there was no economic hardship. Instead, respondent asserted in the Tax Court that "financial hardship is a personal matter, rather than a business consideration." (61 TCM, at 2531, col. 2, para 4.) For an employee of a large New York City corporation whose husband's public interest legal work has led to the loss of her New York City apartment, that platitudinous phrase has a hollow ring.

In effect, the Commissioner's argument in the Tax Court and in the Court of Appeals was that economic hardship can never give rise to business necessity. That proposition does not find support in *Flowers*. As was developed by the testimony in the Tax Court, the Vermont home could not be sold except at a drastic loss and petitioners could not afford to purchase a cooperative or rent an apartment in the New York City area for a temporary period. It made business sense and was reasonable to weather the storm by contracting the intermittent use of a room three nights per week in Manhattan from a friend and preserving the wife's regular employment by engaging in the temporary travel pattern disclosed by the record.

The holding of the Court of Appeals in the case at bar that *Flowers* does not recognize financial hardship as one form of business necessity should be firmly rejected by this Court.

CONCLUSION

For the foregoing reasons, this petition for certiorari should be granted.

Dated: July 22, 1993

Respectfully submitted,

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APPENDICES

APPENDIX A

{CCH Dec. 47,323(M)} A. Lawrence Washburn, Jr. and Susanne Washburn v. Commissioner.

Docket No. 8580-88. T.C. Memo. 1991-1995. Filed May 1, 1991 [Appealable, barring stipulation to the contrary, to Ca-2—CCH.]

[Code Sec. 162]

Expenses—trade or business: Commuting expenses: Travel expenses—Expenses of commuting from an individual's home in Vermont to a part-time job in New York City were nondeductible personal commuting expenses. The expenses were incurred because of petitioner's personal choice of where to live.

[Code Sec. 166]

Bad debt: Business: Basis: Evidence.—No business bad debt deduction was allowed to an attorney on the cash basis of accounting for an uncollected account receivable where such amount was not previously included in income and it had no tax basis.

[Code Sec. 6653—Prior to amendment by P.L. 101-239]

Additions to tax: Penalties: Negligence: Evidence—Additions to tax negligence penalties and additional interest were properly imposed where an underpayment of tax resulted from a claimed bad debt deduction that was clearly not allowable.

[Code Sec. 6661—Prior to repeal by P.L. 101-239]

Additions to tax: Penalties: Substantial understatement of tax: Reduction: Adequate disclosure—An additions to tax penalty for a substantial understatement of tax was properly imposed and no reduction of such penalty was allowed absent evidence of adequate disclosure of substantial authority for the adjustments in issue—C.C.H.

A. Lawrence Washburn, Jr., *pro se*. Scott P. Borsack, for the respondent.

Memorandum Findings of Fact and Opinion

SWIFT, Judge: Respondent determined a deficiency in petitioners' 1984 Federal income tax liability and additions to tax as follows:

	Additions to Tax. Secs.[1]		
Deficiency	*6653(a)(1)*	*6653(a)(2)*	*6661*
$11,315.20	$565.76	50% of the interest due on $8,053.00	$2,828.80

After settlement of a number of issues, the primary issues remaining for decision are: (1) Whether petitioners, as cash basis taxpayers, may claim a bad debt deduction under section 166 for an unpaid debt with respect to which they had no tax basis; (2) whether petitioner Susanne Washburn may deduct under section 162 expenses incurred in traveling between her residence in Vermont and her place of business in New York City; and (3) whether petitioners are liable for additions to tax as determined by respondent.

Findings of Fact

Some of the facts have been stipulated and are so found. Petitioners resided in Dorset, Vermont, at the time they filed their petition in this case.

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[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954 as in effect for the year in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

Petitioner A. Lawrence Washburn is an attorney, licensed to practice law in the State of New York. After graduating from law school in 1966, Mr. Washburn worked for several law firms in New York City, where he resided with his wife, petitioner Susanne Washburn, and three children.

Due to financial difficulties, petitioners in 1978 sold their apartment in New York City, and from 1978 until 1983 petitioners and their children resided in the apartment of Mr. Washburn's mother, also in New York City.

In 1983, Mr. Washburn's mother sold her apartment and moved to a nursing home. Petitioners then moved their family to a "summer" residence in Vermont, where they lived during 1983 and 1984. Petitioners borrowed approximately $44,000 from a local bank to make the Vermont residence suitable for year-round occupancy.

During 1984, Mr. Washburn rendered legal services to Gene Crescenzi for which he billed Mr. Crescenzi $10,525. Mr. Washburn maintained records with respect to his practice of law on the cash method of accounting and Mr. Washburn did not include the $10,525 billed to Mr. Crescenzi in income for 1984 (nor for any other year). During 1984 and up to the time of trial, Mr. Crescenzi failed to pay Mr. Washburn the $10,525.

During 1984, Mrs. Washburn worked part-time for Time Magazine at its office in New York City. Generally, on Wednesday mornings, Mrs. Washburn drove with her husband from their residence in Vermont the 215 miles into New York City. On Wednesdays, Thursdays, and Fridays of each week, Mrs. Washburn worked at the Time Magazine office.

On Wednesday and Thursday evenings, petitioners stayed overnight in New York City at an apartment they maintained with a friend.

On Friday afternoons, Mr. Washburn alone drove the family automobile the 215 miles back to petitioners' residence in Vermont. Mrs. Washburn worked at the Time Magazine office in New York City until late on Friday evenings and then returned alone by bus to petitioners' residence in Vermont.

Petitioners' total actual automobile expenses for their trips from their residence in Vermont to New York City are not entirely clear from the record. Mrs. Washburn's total bus fare in 1984 for traveling Friday evenings from New York City to petitioners' residence in Vermont was $1,625.

During 1984, total deposits to petitioners' bank accounts were $83,330. The sources and amounts of the deposits identified at trial were as follows:

Source	*Amount*
Susanne's wages	$21,789
Mr. Washburn's law practice	29,525
Interest	70
Returned checks	554
Medical Insurance reimbursements	404
Miscellaneous nonincome items	633
Mortgage proceeds	28,394
Miscellaneous income	600
TOTAL	$81,968*

**Due to rounding, the total does not reflect the sum of the amount shown in the column.*

The $1,362 difference between the total bank deposits of $83,330 and the identified deposits of $81,968 was not identified by petitioners beyond a general assertion that it did not represent income.

On their 1984 joint Federal income tax return, petitioners claimed a deduction for business travel expenses under section 162 with respect to Mrs. Washburn's pro rata share (one-half) of the mileage

for their weekly trips from their Vermont residence to New York City. Petitioners also claimed a deduction for the $1,625 in bus fare for Mrs. Washburn's return trips from New York City to Vermont.

As indicated, Mr. Washburn did not report as income the $10,525 in legal fees billed to Mr. Crescenzi, but Mr. Washburn did claim a bad debt deduction for that amount on petitioners' 1984 tax return.

Respondent denied the above deductions and determined that petitioners had $10,362 in unexplained bank deposits that represented additional gross income to petitioners.

Only $1,362 of the $10,362 in bank deposits that was charged to petitioner as income remains in dispute. With regard to the bad debt deduction, respondent has conceded that the $10,525 claimed by petitioners as a bad debt deduction was a valid debt arising from a debtor-creditor relationship created in the course of a trade or business, and that it became worthless in 1984. Respondent, however, denied petitioners' entitlement to a bad debt deduction with respect thereto because Mr. Washburn had no tax basis in the debt.

Opinion

Bad Debt Deduction

Section 166 provides that a deduction will be allowed for debts that become wholly worthless within the year. Worthless debts, however, that relate to unpaid fees or similar unpaid income items will be allowed as deductions only if they have been included in income during the year for which the deduction is sought or for an earlier year. Sec. 1-166.1(e). Income Tax Regs.; *Davis v. Commissioner* (Dec. 43,636] 88 T.C. 122, 142 (1987), affd. [89-1 USTC ¶ 9158] 866 F.2d 852 (6th Cir. 1989); *Gertz v. Commissioner* [Dec. 33,335], 64 T.C. 598, 600 (1975).

Because Mr. Washburn never included the $10,525 in unpaid legal fees in his income, he is not entitled to a bad debt deduction with respect thereto.

Travel Expenses

Section 162(a)(2) provides that a deduction will be allowed for the ordinary and necessary expenses of a trade or business, including travel expenses incurred while away from home in pursuit of a trade or business. Expenses of commuting from one's home to one's primary place of business are not considered business expenses and are not deductible. Sec 1.162.1(e). Income Tax. Regs.

Under *Commissioner v. Flowers* [46-1 USTC ¶ 9127], 326 U.S. 465, 470 (1946), travel expenses must meet three requirements to be deductible. They must be reasonable and necessary, they must be incurred while away from home, and the expenses must be directly related to the carrying on of a trade or business.

Petitioners contend, in essence, that they were forced by economic hardship rather than personal preference to live in Vermont. They contend, therefore, that Mrs. Washburn's travel to and from New York City was necessary for the carrying on of her trade or business. Respondent contends that financial hardship is a personal matter, rather than a business consideration, and that it will not transform what is otherwise a personal commuting expense into a deductible travel expense.

In analyzing claimed travel expenses, this Court has traditionally used a "tax home" analysis where the location of a taxpayer's residence is not clear or does not coincide with his or her principle place of business. *Horton v. Commissioner* [Dec. 42,969], 86 T.C. 589 (1986); *Leamy v. Commissioner* [Dec. 42,481], 85 T.C. 798 (1985); *Barone v. Commissioner* [Dec. 42,382], 85 T.C. 462 (1985), affd. without published opinion 807 F.2d 177 (9th Cir. 1986); *Kroll v. Commissioner* [Dec. 28,864], 49 T.C. 557 (1968); *Stidger v.*

Commissioner [Dec. 26,286], 40 t.C. 896 (1963), revd. [66-1 USTC ¶ 9161] 355 F.2d 294 (9th Cir. 1965), revd. [67-1 USTC ¶ 9309] 386 U.S. 287 (1967); *Green v. Commissioner* [Dec. 16,931], 12 T.C. 656 (1949). They United States Court of Appeals for the Second Circuit (to which an appeal in this case lies), has, however, declined to use the tax home analysis and has instead focused on whether the expenses have a direct connection to the taxpayer's trade or business. *Six v. United States* [71-2 USTC ¶ 9694], 450 F.2d 66, 69 (2d Cir. 1971); *Rosenspan v. United States* [71-1 USTC ¶ 9241], 438 F.2d 905; 911-912 (2d Cir. 1971), See also *Stemkowski v. Commissioner* [82-2 USTC ¶ 9589], 690 F.2d 40, 48-49 (2nd Cir. 1982), affg. in part and revg. and remanding in part [Dec. 37,680] 76 T.C. 252 (1981).

Clearly, in the Second Circuit, expenses that are incurred because of a taxpayer's personal choice of where to live are not deductible. *McCabe v. Commissioner* [82-1 USTC ¶ 9331], 688 F.2d 102, 106 (2nd Cir. 1982), affg. [Dec. 37,955] 76 T.C. 876 (1981); *Carragan v. Commissioner* [52-1 USTC ¶ 9317], 197 F.2d 246, 249 (2nd Cir. 1952), affg. a Memorandum Opinion of this Court [Dec. 18,200(M)]. This authority requires the disallowance of Mrs. Washburn's share of the automobile expenses and the bus expenses she incurred in traveling each week back and forth between New York City and petitioners' residence in Vermont. New York City was Mrs. Washburn's only place of business, and for personal reasons she chose to live in Vermont. The fact that it was less expensive to live in Vermont does not convert her personal commuting expenses into deductile business expenses.

Unreported Income

With regard to the $1,362 in unexplained bank deposits still in dispute, the burden is on petitioners. Rule 142(a). Petitioners have not offered any proof as to the origin of the $1,362, and we therefore treat the $1,362 as income.

Additions to Tax

Additions to tax under section 6653(a)(1) apply where any part of a deficiency is due to negligence or to intentional disregard of rules or regulations. Negligence is defined as the failure to use due care or to do what a reasonable and ordinarily prudent person would have done under the circumstances. *Neely v. Commissioner* [Dec. 42,540], 85 T.C. 934, 947 (1985). Intentional disregard of rules or regulations has been found where taxpayers departed from the plain language of the applicable statutes or regulations, absent a showing that such language produces absurd or unfair results or contravenes the intent of Congress. *Druker v. Commissioner* [83-1 USTC ¶ 9116], 697 F.2d 46, 53 (2d Cir. 1982), affg, in part and revg. in part [Dec. 38,346] 77 T.C. 867 (1981) Respondent's determination is presumptively correct and the burden is on petitioners to prove that they were not negligent. *Betson v. Commissioner* [86-2 USTC ¶ 9826, 802 F.2d 365, 372 (9th Cir. 1986), affg. in part and revg. in part a Memorandum Opinion of the Court [Dec 41,219(M)]; *Luman v. Commissioner* [Dec 39,500], 79 T.C. 846, 860-861 (1982).

Petitioners made several mistakes on their 1984 Federal income tax return. They claimed a bad debt deduction that was clearly not allowed by the plain language of applicable regulations. We hold that petitioners are liable for the additions to tax under section 6653(a)(1). We also hold that petitioners are liable for the additional interest under section 6653(a)(2) with respect to the portion of the tax deficiency arising from the disallowance of the bad debt deduction, Mrs. Washburn's travel expenses, and the $1,362 in unreported income.

Section 6661 imposes an addition to tax if there is a substantial understatement of income tax in a given year. An understatement is defined as the excess of the amount of tax required to be shown on the tax return over the amount of tax actually shown on the return as filed less any rebates. A substantial understatement is one that

exceeds the greater of either 10 percent of the tax required to be shown on the return or $5,000.

In calculating understatements under section 6661, items for which there is substantial authority or with respect to which all relevant facts were adequately disclosed in the tax return, or in a separate statement attached to the tax return, are not to be considered. Sec. 6661(b)(2)(B).

Petitioners have not shown that they had substantial authority for the three adjustments at issue, nor that they adequately disclosed the relevant facts with respect thereto on their 1984 tax return. Petitioners also are liable for the addition to tax under section 6661.

Decision will be entered under Rule 155.

APPENDIX B

United States Court of Appeals

FOR THE SECOND CIRCUIT

(Stamp)Received May 17, 1993
United States Tax Court

(Stamp) United States Court of Appeals
Filed Mar 26, 1993
Elaine B. Goldsmith, Clerk
Second Circuit

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the city of New York on the 26th day of March, one thousand nine hundred and ninety-three.

PRESENT:

HON. FRANK X. ALTIMARI,
HON. JOHN M. WALKER, JR.
Circuit Judges

HON. MORRIS E. LASKER
Senior District Judge, (U.S. District Court for the Southern District of New York, sitting by designation).

A. LAWRENCE WASHBUTN, JR.,
SUSANNE WASHBURN,
Petitioners,

-against- 92-4005

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

THE MANDATE, CONSISTING OF THE ITEMS BELOW, HAS BEEN RECEIVED. ORDER RECEIVED BY E.W.A. DATE 5/18/93

Return to Team One

Appellants, A. Lawrence Washburn, Jr. and Susanne Washburn, appeal from a judgment of the United States Tax Court upholding the Commissioner of Internal Revenue's findings that they are liable for tax deficiencies and additions to tax under the Internal Revenue Code (26 U.S.C. § 1 et seq.) ("the Code").

This cause came to be heard on the transcript of record from the United States Tax Court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the judgment of the tax court is AFFIRMED.

Taxpayer, A. Lawrence Washburn, Jr., is an attorney licensed to practice law in New York. Washburn moved his family to a house in Vermont in 1983 where they continued to live during 1983 and 1984. During 1984, Washburn rendered legal services to a client in the amount of $10,525 for which he subsequently billed the client but never received payment. Washburn maintained records with respect to his practice of law by the cash method of accounting, and did not include the $10,525 unreceived fee in his income for 1984 or any other year.

During 1984, Susanne Washburn worked part-time for Time Magazine at its office in New York City. Generally, on Wednesday mornings, she would drive with her husband from their residence in Vermont the 215 miles into New York City. Both would stay in the city in an apartment they maintained with a friend until Friday. On Friday afternoons, Mr. Washburn drove back home to Vermont alone. On Friday evenings, Mrs. Washburn traveled home by bus.

On their joint income tax return for 1984, the Washburns claimed, under I.R.C. § 166(a)(1), a business bad debt deduction for the legal fees that were owed but never paid to Mr. Washburn. However, as was noted above, these fees were not included as income on that or any other return. In addition, the Washburns claimed, under I.R.C. § 162(a)(2), a business expense deduction for travel expenses, namely, Mrs. Washburn's pro rata share (one-half) of the mileage for the weekly trip into the city and the amount of the bus fare, totalling $1,625, for the trip back to Vermont.

Upon audit, the Commissioner determined that Mrs. Washburn's traveling expenses constituted non-deductible personal expenditures under I.R.C. § 262(a) because they were incurred due to a personal choice of where to live. In addition, the Commissioner determined that the taxpayers could not claim a business bad debt deduction with respect to the unpaid legal fees owed to Mr. Washburn because they had not been reported as income. The tax court upheld these determinations. The Washburns now appeal.

On appeal, the Washburns argue that requiring a cash basis taxpayer to claim an unpaid fee as income before allowing the unpaid fee to be deducted as a bad debt is unfair, unreasonable, and inconsistent with the Code in light of its 1942 amendment. Further, the Washburns contend that the expenses incurred by Susanne Washburn by traveling from her home in Vermont to her place of work in New York City are deductible travel expenses because the Washburns lived in Vermont due to financial hardship rather than personal choice.

Although § 166 of the Code allows a deduction for business bad debts that became worthless during the taxable year, the Treasury Regulations on Income Tax, specifically § 1.166-1(e), requires that certain types of income, including unpaid fees, are required to be previously reported as income in order to be claimed as a deduction. Treas. Reg. 1.166-1(e). Considering the purpose of allowing for a bad debt deduction, namely to provide tax relief to those taxpayers

who have reported as income items that they have failed to receive, *see Citizen's Acceptance Corp. v. United States*, 472 F.2d 751, 756 (3d Cir. 1972), it is not unreasonable or unfair to deprive a cash basis taxpayer this deduction under circumstances where the item has not been reported as income in the first instance. See 8 Mertens, Law of Federal Income Taxation § 30.27 (1991).

Treasur. Reg. § 1.166-1(e) does not impose upon taxpayers a requirement that Congress removed from the Code by the 1942 amendment to § 166. The Revenue Act of 1918 § 214 (a)(7) allowed for deductions only debts that became worthless *and* were "charged off" in the taxable year. Congress' removal of the "charged off" language eliminated the requirement that the taxpayer "charge off" the debt on her books in the year that the debt become worthless and claim the deduction. In contrast, § 1.166-1(e) requires the taxpayer to report the debt as income before it can be claimed as a bad debt deduction rather than require the taxpayer to "charge off" the debt on her books.

In general, the Code does not provide deductions for personal, living, or family expenses. I.R.C. § 262(a). The cost of travel is normally considered a nondeductible personal expenditure. *See United States v. Correll*, 389 U.S. 299, 301-02 (1967); *Ellwein v. United States*, 778 F.2d 506, 509 (8th Cir. 1985); *Neal v. Commissioner of Internal Revenue*, 681 F.2d 1157, 1158 (9th Cir. 1982). However, § 162(a)(2) provides an exception to this rule and allows for the deduction of traveling expenses incurred by the taxpayer while away form home in pursuit of a trade or business. The Supreme Court held that three conditions must be satisfied to come under the exception provided for in § 162: (1) the expense must be reasonable and necessary; (2) it must be incurred while taxpayer is away from home; and (3) the expenses must be incurred in pursuit of a trade or business. *Commissioner of Internal Revenue v. Flowers*, 326 U.s. 465, 470 (1946). In this case, the Washburns sought to deduct the travel expenses incurred by Susanne Washburn

by traveling from her home in Vermont to her workplace in New York City. Consequently, it was necessary for them to show that the travel expenses were the result of the exigencies of her employment rather than her personal choice of where to live. *See Flowers*, 326, U.S. at 474.

We are unpersuaded by the argument that because the Washburns lived in Vermont due to financial hardship, the expenses incurred arose out of business necessity rather than from a personal choice of where to live. If this argument were to prevail it would result in all taxpayers being able to claim their traveling expenses as deductions in circumstances where they could not afford to maintain a residence near their place of work. This result would be inconsistent with the teaching of *Flowers*. *See Id.*

Accordingly, the judgement of the tax court is AFFIRMED.

s/Frank X. Altimari
FRANK X. ALTIMARI

s/John M. Walker, Jr.
JOHN M. WALKER, JR.,
Circuit Judges,

s/Morris E. Lasker
MORRIS E. LASKER,
Senior District Judge.

N.B. THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND SHOULD NOT BE CITED OR OTHERWISE RELIED UPON IN UNRELATED CASES BEFORE THIS OR ANY OTHER COURT.

APPENDIX C

United States Tax Court

A. LAWRENCE and SUSANNE WASHBURN, JR.,
Petitioners,

v. Docket No. 8580-88

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the opinion of the court filed May 1, 1991, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: at there is a deficiency in income tax due from the petitioners for the taxable year 1984 in the amount of $6,924.00;

That there is an addition to tax due from the petitioners for the taxable year 1984, under the provision of I.R.C. § 6653(a)(1), in the amount of $346,20;

That there is an addition to tax due from the petitioners for the taxable year 1984, under the provisions of I.R.C. § 6653(a)(2), in an amount equal to 50 percent of the statutory interest due on $4,743.00 from April 15, 1985, to the date of assessment of the tax or, if earlier, the date of payment of the tax; and

That there is an addition to tax due from the petitioners for the taxable year 1984, under the provisions of I.R.C. § 6661, in the amounts of $1,731, respectively.

s/Stephen J. Swift\
Judge

Entered: October 15, 1991

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision herein.

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Date: s/Sept 27, 1991

Date: (stamp) Oct 2 1991